

# IT's alpha returns are no longer assured

Dipti Sharma

dipti.sharma@livemint.com

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In the past six months, some mid- and small-cap information technology (IT) stocks have lost more than a third of their value, according to a *Mint* analysis, raising questions about where alpha returns will come from next.

Over the same six months, Nifty Smallcap 250 index has fallen just over 4%, while the Nifty IT index has shed 15%.

Liquidity constraints and investor caution have hit smaller IT firms harder than their large-cap peers, exposing vulnerabilities in revenue diversity and balance-sheet strength, market participants said. Large-cap companies, by contrast, benefit from scale, deeper client relationships, and financial heft, offering some downside cushion.

Investor positioning in the sector has shifted repeatedly over the years. There was a period when alpha was expected from large-cap IT, but that narrative faded. Mid- and small-cap names then emerged as the next source of market-beating returns. With their steeper corrections, however, their place in a superior-return portfolio is now under question.

"Certain mid and small-cap names that occupy niche verticals and can credibly pivot around the AI (artificial intelligence) theme, whether through AI-led delivery, platform plays, or specialized data services, should start to separate from the pack," said Prabhakar Kudva, director and



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principal officer, portfolio management service, Samvitti Capital.

Indian IT companies are already moving on this front, deploying AI in client delivery and infrastructure projects.

Infosys has partnered with Anthropic to develop enterprise AI solutions across telecom, financial services, manufacturing and software development. Tech Mahindra has teamed up with Nvidia to strengthen its AI capabilities, while Tata Consultancy Services Ltd (TCS) and

Advanced Micro Devices have expanded their collaboration to build large-scale AI data centre infrastructure in India. Beyond the medium term, the sector's trajectory will hinge on AI adoption, believe money managers. The real winners, they said, will be companies that successfully adapt to the post-AI landscape, whether by

building products, embracing AI-led delivery, or moving up the value chain.

But that is a two-to-three-year story. Until there is clear evidence that these pivots are translating into growth and earnings traction, many fund managers believe staying overweight on IT could mean missing better opportunities elsewhere.

**With steeper corrections in mid- and small-caps, their place in a superior-return portfolio is now in question**

Market participants also noted that technology companies have struck a measured tone on AI's impact, even as investors appear to be pricing in that uncertainty far more quickly.

Jefferies has called India the reverse AI trade, though the firm sees another angle to the story. In its 19 February *GREED & Fear* report, Christopher Wood said companies are likely to build small, customized language models using proprietary databases, with Indian IT services firms

helping clients transition to this approach. At the same time, AI adoption is rising, with around 90% of Infosys's top 200 clients already using its AI services.

"The above is clearly a positive from an Indian market standpoint since it means there may be a future for the Indian IT services sector which has been perceived as being a big loser from AI and which has been a big underperformer in an Indian stock market context and even more so in a global emerging market context," the report said.

Recent performance highlights the correction. Over six months, Coforge and Oracle Financial Services have fallen more than 26% and 22%, respectively. In the Nifty MidSmall IT & Telecom index, Hexaware Technologies and KPIT Technologies are down 37% and 32%.

Even large-cap IT faces limits as a defensive play.

"As for large-cap IT regaining favour as a defensive trade, I would be cautious on that," said Kudva. Are there better opportunities elsewhere? Certainly appears so. "Broader market's earnings expectations are better than large-cap IT stocks, but risk-reward for the latter is getting interesting with a -5% FY27 FCF yield at current prices," said Harsh Gupta Madhusudan, fund manager, PIPE, Ionic Asset.

The broader view is that market-beating returns is unlikely to come from the IT sector, at least over the next few quarters.

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